

STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET DE 04-177

ORIGINAL	
A.H.P.D.C. Case No.	DG-08-009
Exhibit No.	#58
Witness	Chattopadhyay Pradip
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IN THE MATTER OF: Public Service Company of New Hampshire,
Transition Energy Service Rates

DIRECT TESTIMONY

OF

Maureen L. Sirois
Utility Analyst III

Regarding the Return on Equity for
Public Service Company of New Hampshire's Generation Assets

April 20, 2005

1 Section II, I describe the methodology I apply to estimate my rate of return on equity
2 recommendation for PSNH's generation plants. Then, in Section III, I compare and
3 contrast my methodology and recommendations with those of the Company's witness
4 Dr. Roger A. Morin. In Section IV, I summarize my recommendations.

5 **Section I: The Economic and Financial Environment**

6 **Q What relevance do economic and financial conditions have in this proceeding?**

7 A Investors consider both economic and monetary conditions when assessing the
8 opportunity costs of their investment. For instance, investors respond to changing
9 assessments of risk and financial prospects by changing their willingness to pay for a
10 security. During times of uncertainty, investors are less willing to invest in high-risk
11 equity. As a result, the lower demand for high-risk equity causes prices to fall,
12 increasing dividend yield and the return on equity. Meanwhile, investors seek less
13 risky equity, such as electric utility stocks, thereby increasing the value of those
14 stocks and decreasing the expected return on equity.¹ Currently, the economy is
15 growing at a steady pace; however, high oil and natural gas prices and the
16 uncertainties associated with the war in Iraq appear to be lowering investors'
17 expected rate of returns. Moreover, investors are attracted to safer equity, such as
18 equity offered by electric utilities.

19 Macroeconomic conditions and capital markets are also relevant because they
20 affect the variables that intervenors use to assess returns on equity, such as stock

¹ The S&P Electric Utilities Index was up 19.6 percent in 2004, compared with gains of 9.0 percent for the S&P 500 Composite Stock Index and 10.0 percent for the S&P 1500 Super Composite Stock Index. These trends reflect an investor shift to the utility sectors, which is considered a safer alternative to the broader market due to the uncertainties created by the increase in oil prices. McCann, Justin C. *Industry Surveys, Electric Utilities*, Standard & Poor's, February 17, 2005, page 5.

1 prices, interest rates and dividend growth. Moreover, it is important to put the
2 Company's currently allowed rate of return on equity in an historical context since it
3 was set in 1997 and its use was continued through the PSNH Restructuring
4 Settlement proceeding in 1999 and 2000.

5 **Q How have economic conditions changed since 1997?**

6 A During the Company's temporary rate case in 1997, the nation experienced an
7 economic peak, during which inflation and unemployment were at moderate levels
8 and interest rates were high. Currently, the economy is recovering from the
9 recession, which started in March 2001 and ended in March 2002.² The annual
10 growth rate of the national economy, as measured by the rate of change in the Real
11 Gross Domestic Product (Real GDP), has increased in recent years to 4.4 percent in
12 2004. Inflation, as measured by the rate of change in the Consumer Price Index
13 (CPI), has increased slightly over the past year and remains at moderate levels. The
14 national unemployment rate has decreased gradually from highs set in 2003.
15 However, the national unemployment rate is still higher than it was in 1997 and 2000.
16 In fact, participation in the labor force has decreased, which is evidenced by a current
17 employment to population ratio that is lower than 1997 and 2000. Since the economy
18 is still recovering from the last recession, investors will most likely be attracted to
19 less risky equity, such as equity offered by utilities.

² "The NBER's Business-Cycle Dating Procedure" June 7, 2002, National Bureau of Economic Research,
<http://www.nber.org>